

in « *L'entreprise, le chiffre et le droit* », éditeurs J.G. Degos et S. Trébucq, Bordeaux (2005), pp. 305-327.

# The merchant banker, the broker and the Company chairman: a new issue case study

**Jeannette RUTTERFORD**

Professor

Open University Business School, Michael Young Building, Walton Hall,  
Milton Keynes, MK7 6AA

Tel: 01908 655 812 ; Fax: 01908 655 898

Email: [j.rutterford@open.ac.uk](mailto:j.rutterford@open.ac.uk)

## Acknowledgements

My thanks to the archivists and staff of the Manuscripts Section of the Guildhall Library for helpful assistance and to Professor Tony Arnold and participants at the 2004 ABFH conference held at Cardiff University.

## Abstract

*This paper explores the roles of a merchant banker, Everard Hambro, and the chairmen of two companies, Thames Iron and Trollope, Colls & Co., in the restructuring of their companies at the beginning of the twentieth century. Their correspondence provides evidence that the choice of corporate capital structure had little to do with company needs or risk characteristics. Instead, Hambro, in concert with stockbrokers, concentrated on legal issues and on ensuring that the securities issued conformed in amount, type and price to market norms, including the avoidance of stock watering. The company chairmen concentrated on ensuring that they retained control and that the new issues were deemed a success.*

## Keywords

*Corporate finance, stock watering, underwriting, new issues*

## 1 - Introduction

*'The London merchant banks ... were under no temptation to dabble in home industrial issues'<sup>1</sup>*

One of the major issues in economic history is whether or not the British banks and stock markets failed British industry in the late Victorian and Edwardian eras (Paish, 1951; Cairncross, 1953; Kennedy, 1990). The supposed failure of the City to provide long-term finance to British companies has been explained by the preference of brokers and City

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<sup>1</sup> Cairncross, 1953: 90.

bankers for financing overseas companies and governments, which offered greater economies of scale and higher returns when compared with financing British industry. Indeed, the City's support for a fixed exchange rate and free trade to facilitate their international business may have had a detrimental effect on domestic industry, by forcing British companies to operate in a highly competitive environment, without the benefit of monopoly rents available, say, to American trust companies. The major City families operated a highly effective network, able to influence government policy, enrich themselves through the financing of international governments and utilities, and leaving the financing of British industry, particularly small firms, to financial agents operating at the fringe of the stock market (Ingham, 1984; Lisle-Williams, 1984; Cassis, 1994). Harrison (1981) documents a new technology industry, that of the bicycle, which had difficulties in raising external finance and points to small firms as being the major sufferers. Indeed, firms with less than £100,000 requirement for funds, were denied access to the new issue market in London (Ingham, 1984: 148). It has been argued that not only were merchant bankers unwilling to meddle in industrial issues because of social and cultural differences, but also that such 'gentlemanly' banking reduced the need for competence or even effort on the part of the bankers (Lisle-Williams, 1984).

Critics of such a view have countered that the lack of provision of long-term finance for British industry can be explained by a lack of demand on the part of industrialists (Davis, 1966; Thomas 1978). From the early nineteenth century onwards, there is ample evidence that newly formed companies financed themselves through family and work networks (Rose, 1979; Colli, 2003). When firms became limited liability companies in the late nineteenth and early twentieth centuries, Baskin and Miranti (1997) have argued that owners deliberately chose not to offer ordinary shares to the investing public, preferring to issue fixed interest and fixed dividend securities in order to both retain control and excess profits. This led to a form of paternalistic capitalism which persisted well into the twentieth century (Chandler, 1990; Colli, 2003). Indeed, ironically, the merchant banking sector in London is a classic example of an 'industry' in which ownership and management were as one. Thus it seems to be a story of on the one hand the banks and City institutions failing to provide the necessary capital, either for economic or social reasons, and on the other of selfish capitalists, eager to retain control and profits rather than expand and share wealth accordingly.

In this paper, we explore these issues through the correspondence between the firm of Hambro, a well-known merchant bank, and two firms - one a British shipbuilding company, Thames Ironworks Shipbuilding and Engineering Co. Ltd. ("Thames Iron"), the other a building and decorating firm, Trollope, Colls & Co. Ltd. ("Trollope. Colls & Co.") - in the context of capital raising in 1899 and 1903 respectively. The role played by Hambro and the stockbrokers involved sheds light on whether the City helped or hindered the financing of British industry and allows comparison with the role played by bankers, such as J.P. Morgan, in the US. The correspondence between Hambro and the two chairmen reveals the financial issues at stake – what were the costs of financing including charges by intermediaries such as Hambro? What were the asymmetries of information, in particular the quality of information provided in the prospectus? How did the City's financial and social networks actually work? What was the role of Hambro in these new issues?

The correspondence allows us to examine how – and by whom - the capital structures were chosen for two firms in very different industries. Few authors, excepting Jefferys (1938) and Baskin and Moranti (1997) have given attention to the development of norms in the British corporate finance arena, although Hautcoeur (1999) has done some work on this for the

period 1890 to 1936 for the French market. Jefferys (1938: 459-60) documents differences, for example, in capital structure between the brewing; coal, iron and steel; and industrial and commercial companies. How did these differences arise? On a more theoretical level, how close were bankers of the period to economic optimality? How did they choose between debt and equity? In the absence of significant corporate taxation, did bankruptcy costs or signalling mechanisms hold sway? This paper uses the correspondence relating to the flotations of both Thames Iron and Trollope, Colls & Co. Stock Exchange documents, prospectuses, annual accounts, financial periodicals and directors' reports to examine how the particular capital structures were determined and how costs were estimated, building on an approach developed by Baskin and Moranti (1997: chapters 4 and 5).

It is the contention of this paper that the close-knit financial community in the City led to relatively low new issue costs, and allowed rapid access to external funding for companies such as Thames Iron and Trollope, Colls & Co. This speed was helped by standard procedures and comparators applied to each new issue in turn. It would appear that the asset base of the firm and the current norms for income cover and debt/equity ratios determined the capital structures for the two reconstructions rather than industry standards which took relative risk into account. Hambro as merchant banker made no attempt to understand the businesses he floated, relying on market practice and his broker contacts to determine what the market would accept, rather than what would be best for the firms. The downside of applying these rules of thumb was to fail to take into account the different financial risks and needs of each company and to allow financial structures inappropriate to the businesses concerned. Each transaction was done individually, with no long-term relationships established or directorships taken on the Boards of client firms. Taking no interest in Thames Iron, for example, other than the legal and market issues related to the flotation, Hambro did not think strategically in sector terms nor promote a restructuring of the industry along J.P. Morgan lines. Neither did he use his government contacts to help a firm dependent on government business. No attempt was made to build a long-term relationship. Despite several new injections of funds, raised independently of Hambro over the next ten years, Thames Iron went into liquidation and closed down in 1912. Trollope, Colls & Co., however, survived and is now part of the Kvaerner group.

A brief introduction to Thames Iron is provided in the following section. The paper then explores how the capital structure decision was made for the Thames Iron restructuring of 1899, in the light of the correspondence between Hambro and Hills, Chairman of Thames Iron. The role of asset valuation and disclosure of profits for the prospectus is considered, followed by the role of the broker and the underwriting decision in the new issue process. The paper then looks at the 1903 new issue made by Hambro for Trollope, Colls & Co. before concluding with a section exploring the role of Hambro in the financing of British industrial and commercial companies at the beginning of the twentieth century and the fate of the two companies in later years.

## **2 - The History of Thames Iron**

Thames Iron is a company with a fascinating history. Originally established by Charles J. Mare in 1846, it was one of the leading ship-building firms on the Thames from the 1850s, building the first ironclad warship, the *Warrior*, in 1859, thereby becoming a household name (Pollard, 1950: 72-89). It suffered a number of downturns, being re-formed in 1864 and 1870 (Pollard, 1950; Arnold, 2000). Its banking relationships were problematic, with Prescotts

bank pressed to lend £50,000 when a Turkish debtor had defaulted following the banking crisis initiated by the collapse of Overend Gurney in 1866. Prescotts did so reluctantly, noting that it only did so as 'many of our customers are shareholders'. In 1870, after the restructuring, Prescotts refused to become the new company's banker, being replaced by London & Westminster (Souden, 2003: 128).

Originally run by Mare and his MP father-in-law, Peter Rolt, influence had shifted by the 1870s to F.C. Hills, a successful Deptford chemist. His son, Arnold Hills, joined the board in 1880 and later became managing director. One of three sons, Arnold Hills attended Harrow and Oxford, was a champion footballer and held the record for the mile in 1878, although his official biographer was grudging in praise, commenting that he won the three-miles race at the inter-university championship in 1879 in 'creditable time'. Concerned with worker welfare, Arnold Hills spent the first five of his years at Thames Iron living in the East End of London, 'devoting his days to the shipyard and his evenings to the recruitment and recreation of his workpeople' (*The Times*, 8 March 1927). He organized many educational and recreational clubs, of which the most famous became West Ham United Football Club. He was President of the London Vegetarian Society and of the Vegetarian Cycling and Athletic Club. He funded the first vegetarian restaurant in Britain and was a firm teetotaler, arguing that he had been 'led to the conclusion that it is the American habit of abstinence from alcohol that is one fundamental cause for their commercial prosperity' (*Thames Ironworks Quarterly Gazette*, 1895, 3: 152).

In the 1880s and early 1890s, the firm suffered industrial unrest. Although the Thames ship-building workers were better paid than their counterparts on the Clyde and the Tyne,<sup>2</sup> they were still prepared to down tools. Hills believed in having the freedom of choice of labour, and Thames Iron endured a number of strikes<sup>3</sup> with Hills having a proposed profit-sharing scheme voted down. He took this to heart, writing later in the *Thames Iron Quarterly Gazette* that he would 'not easily forget the brutal rejection. I was assumed to possess some Machiavellian instinct of tyranny' (*Thames Ironworks Quarterly Gazette*, 1895, 1: 23). However, in 1892, Hills was able to introduce a Good Fellowship Scheme that paid out bonuses to groups of workers if contracts came in under budgeted cost, and, in 1894, an eight-hour day (*Thames Ironworks Quarterly Gazette*, 1897, 9: 99-101; Arnold, 2000: 138). By 1899, Hills was able to comment, with satisfaction:

The Good Fellowship system (which gives to every workman a direct interest in the work he has in hand) was established with the consent of the Directors to create a more friendly order of things in the Works. It has proved in every way satisfactory beyond our anticipations. Our business has increased ... Our costs have decreased by some 17 to 18 per cent while ... monthly dividends have been paid to the workmen in addition to the highest wages paid in the Kingdom, and in addition to the Eight Hours Day, which the success of the Good Fellowship System justified us in introducing.<sup>4</sup>

By the 1890s, the ship-building industry was becoming more dependent on war ships. As a result, a number of mergers between ship-builders and armaments manufacturers took place, notably Vickers Barrow and Maxim, and Armstrong Mitchell with Whitworth (Pollard, 1950;

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<sup>2</sup> Bids by Thames shipbuilding firms were on average 9.4% higher than the successful bids in the period 1889 to 1996. (Hills, 1896, cited in Arnold, 2000: 136).

<sup>3</sup> Including, at different times, (a) boilermakers, (b) shipwrights, (c) engineers, (d) carpenters, (e), labourers, Directors' Report for 1898, MS19096, Guildhall Library.

<sup>4</sup> Thames Iron Directors' Report for 1998, in MS19096.

Arnold, 2000: 124).<sup>5</sup> Thames Iron, operating on a smaller scale, although the largest shipbuilding firm on the Thames at the time, chose to merge with a small local firm, John Penn & Sons, engine-makers and engineers. The sums involved were not disclosed, although later correspondence hints at an asset value for Penn of £100,000.<sup>6</sup>

In the next section, I look at how the capital structure for the flotation of Thames Iron after the merger with John Penn & Sons was decided upon by Hills and by Hambro.

### 3 - Thames Iron's Capital Structure

The first evidence of written contact between Hambro and Arnold Hills of Thames Iron is a letter dated 14 May 1899 from Arnold Hills in which Hills discusses Canadian mining companies in which he was an investor, inviting Hambro to also invest, as well as inviting Hambro to stay at his holiday home in Cromer. 'The links are charming, and tho' a bad player, I shall some day like to have a round with you'. In a letter dated four days later, on 18 May 1899, Hills produced a first draft of a prospectus outlining a proposed preference share issue for Thames Iron.<sup>7</sup> This draft was clearly based on previous discussions which are not minuted in the archive. The then authorised capital of Thames Iron was £500,000, split equally between ordinary and preference shares, with an issued capital of £200,000 ordinary shares and £150,000 5 per cent preference shares, preferred as to dividend only and not cumulative. The new issue was to be of a further £100,000 of the 5 per cent preference shares, with the remaining preference shares and the balance of the ordinary shares already held by the directors of the Company, and £150,000 of debentures.

In his draft Prospectus, Hills was honest enough to state that the preference share issue was 'to meet the convenience of the Chairman who is the principle [sic] holder of the company's shares'. It is likely, therefore, that the issue was to repay loans made by Hills to the company<sup>8</sup>, or at least to provide additional working capital required after the merger with John Penn & Sons<sup>9</sup>. The new issue was of a security already in issue and should therefore have been a relatively simple matter.

However, Hambro perceived a problem: the market did not like non-cumulative preference shares.<sup>10</sup> Hambro wrote by reply to Hills, thanking him for his enclosure which

reads well as regards all but one thing – We had understood that the preference shares were really preferred in every sense, both capital and interest, and in fact would be a first lien on everything after the Debentures were satisfied and it was under that idea we had been talking but if they are really ordinary shares, but preferred as to dividends, each year for itself only, they have all the risk of the ordinary and none of the sweets ... I am very sorry that we have given you so much trouble but as now put, tho' I think the Co could quite offer them themselves to the public, I do not see how we could.'<sup>11</sup>

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<sup>5</sup> See also the Prospectus for Vickers Sons and Maxim Limited, MS19096.

<sup>6</sup> Letter from Hambro to Hills, 12 June 1899, MS19096.

<sup>7</sup> Both letters are in MS19096.

<sup>8</sup> As was the case with later issues.

<sup>9</sup> See the Thames Iron Prospectus, MS18000/63B/562.

<sup>10</sup> See, for example, Jefferys, 1938: 225 on how, by the 1880s and 1890s, the market favoured cumulative preference shares.

<sup>11</sup> Letter from Hambro to Hills, 19 May 1899, MS19096.

Thus, Hills had a choice: he could issue new non-cumulative Preference shares under the company name or he could restructure the company, replacing the existing Preference shares with cumulative Preference shares, and issue the new securities with Hambro's name on the Prospectus. In the former case, he might have difficulty when trying to underwrite the issue; in the latter, the restructuring would be more costly but he would have the benefit of the Hambro name and advice. It was important that any 'scheme of combination of ... classes of capital be well thought out' (Le Maistre, 1926: 147).

Hills wrote to Hambro on 31 May 1899, trying to persuade him of the case for not restructuring by including a copy of the latest, glowing, Directors' report – 'in all Departments and in all directions the Thames Iron Works and Shipbuilding Co are more busily and profitably engaged than in any previous period of their existence'.<sup>12</sup> Hambro was not convinced. He had taken legal advice, which had confirmed that the existing preference shares could not be made cumulative.<sup>13</sup> He had also sent his legal expert, Board, to visit the company at Thames Iron's offices in Deptford, attend the General Meeting and try to persuade the Board of a need for a new capital structure, to include cumulative preference shares. He wrote back, thanking Hills, 'but as all Preference shares of similar companies so far offered to the public, have been cumulative in every sense of the word, I do not see how I can come back on my last letter and make any public issue of your company's preference shares'.<sup>14</sup>

In the face of Hambro's adamancy, Hills wrote to Hambro the same day conceding the need for a new capital structure and suggesting £375,000 each of cumulative preference shares and ordinary shares. 'This issue would provide capital £600,000 for the purchase of the present company's properties (premises, plant, contracts, goodwill, &c.) and leave £100,000 for the purchase of stocks (say £50,000) and working capital. Of this issue, which would remove any necessity for the proposed debenture issue of £150,000, I should wish to retain £75,000 in preference shares and £325,000 of the ordinary shares.'<sup>15</sup> Hills provided support for his proposed capital structure with a recent valuation of the aggregate assets of the merged company of 'over £600,000, which with loose tools &c will be increased by say £50,000'.<sup>16</sup>

Hambro did not agree with Hills' proposed capital structure, based on asset backing. He preferred to design the capital structure according to interest cover and the dividend yield on the Ordinary shares, starting from the estimated profit. He replied, again the same day:

I consider that taking the valuation of your assets, which you name as £600,000, and the profits, which you say could be certified by an Auditor averaging £50,000 a year, the Capital you propose would be too large, and that you should rather follow the lines of Messrs. Vickers, Son & Maxim, and most other Companies, and show at least 10% on your Ordinary Stock. Then your Company would have a capital of  
£200,000 Debentures 4% - £8,000 a year  
£200,000 Preference 5% £10,000 a year  
and £300,000 Ordinary showing 10%.

If you approve of this, and if an issue were made, you could get a quotation for the whole if you offered £133,333 of the Pref stock and £200,000 of the Ordinary Stock,

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<sup>12</sup> Thames Iron Prospectus, , MS18000/63B/562.

<sup>13</sup> Letter from Cheston & Sons to Hambro, 30<sup>th</sup> May 1899, MS19096.

<sup>14</sup> Letter from Hambro to Hills, 12 June 1899, MS19096.

<sup>15</sup> Ibid.

<sup>16</sup> Letter from Hills to Hambro, 12 June 1899, MS19096.

always supposing the issue were a success and that the public subscribed for a good portion of it.<sup>17</sup>

Hambro was perhaps also referring to the draft prospectus which Hills had sent with his original 18 May letter to Hambro and which had included the statement: ‘while the last balance sheet (April 1899) enabled the Directors to declare a ten per cent dividend upon the then capital of the Company (£100,000)’.<sup>18</sup> In Hambro’s view, the proportion of Preference shares and Ordinary shares depended on the profit and the desired yield on the Ordinary shares. The greater the proportion of low interest senior securities, the higher the possible dividend on the Ordinary shares.<sup>19</sup>

As well as offering the required dividend yield on the Ordinary shares, which was then key to determining equity values<sup>20</sup>, Hambro’s suggested capital structure had the added advantage of being close to the then norm: in 1898, an official report had found that a capital structure of one third debentures, one third preference shares and one third ordinary shares was ‘almost universal’ (Jefferys, 1938: 227). Hills had suggested issuing Preference shares and debentures in his 18 May letter to Hambro: Hambro had also included debentures as well as Preference shares in his counter-proposal. By the turn of the century, debentures were a popular form of low risk investment – in 1896, the yield on debentures was as low as that on Consols twenty years previously (Watson, 1996). Debentures had been considered attractive as alternatives to equity investment in earlier decades, as they did not have the disadvantage attached to many shares of the time of being partly-paid (Jefferys, 1938: 192). The success of railway debentures, limited to no more than one-third of the authorised capital, also helped their reputation (Baskin and Moranti, 1997: 146). Investment trusts and insurance companies, widely regarded as cautious investors, concentrated their portfolios on debentures (Jefferys, 1938; May, 1912). By the turn of the century, debentures had almost come to be viewed as part of the equity capital of the company, rather than debt. And furthermore, there was an increase in demand by investing institutions and by retail investors for relatively low-risk securities, such as debentures and preference shares (Cottrell, 1980). Including both types of security in the capital structure was more likely to make the issue a success.

The other limiting factor on capital structure was the Stock Exchange requirement that, in order to obtain an official quotation, at least two thirds of the securities intended for public subscription had to be subscribed and allotted (Gibson, 1889: 37; Armstrong, 1990: 117). This explains Hambro’s requirement for £133,333 Preference Shares and £200,000 Ordinary shares to be offered to the public. It is worth noting that, at this point, both Hills and Hambro appeared happy to issue Ordinary shares to the public, although Hills clearly wished to retain control whereas Hambro was following Stock Exchange quotation rules. Hills wanted to retain 20% of the Preference Shares and 87% of the Ordinary shares under his capital structure proposal whereas Hambro needed two thirds to be offered to the public for a Stock Exchange listing to be granted. This Stock Exchange listing was important for any security issue in the eyes of investors: ‘Investors laid special emphasis on companies which received a special settlement and quotation on the Stock Exchange’, despite the fact that the Stock

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<sup>17</sup> Letter from Hambro to Hills, 12 June 189, MS19096.

<sup>18</sup> Letter from Hills to Hambro, 18 May 1899, MS19096.

<sup>19</sup> In the same year, Cotton, in a book on investment, commented: ‘There is no denying that loan capital has been an important factor in the making of dividends.’ Cotton, W. (1898) *Everybody's Guide to Money Matters*, London.cited in Jefferys, 1938: 192.

<sup>20</sup> See Rutterford (2004) for a description of how equities were valued at that time.

Exchange was concerned only with liquidity and legality (Cottrell, 1980: 147). Size was also a factor, with companies having to satisfy the Stock Exchange that they were of 'sufficient magnitude' and, in any case, investors were warned by brokers against investing in any company with a capital of less than £100,000 (Cottrell, 1980: 148, 151).

There were significant changes in the proposed capital structure throughout the period from the initial approach from Hills on 14 May 1899 to the final issue on 26 July 1899. Hills had originally suggested £200,000 ordinary shares, £350,000 of preference shares, and £150,000 of debenture stock, a total of £700,000, with only £100,000 of preference shares being issued to the public. After agreeing to the need to recapitalise the company in view of the need to have cumulative preference shares, Hills then proposed £375,000 each of ordinary and preference shares, a total of £750,000. Hambro responded with a counter-suggestion of £200,000 debentures, £200,000 preference shares and £300,000 ordinary shares, a total of £700,000. The draft prospectuses show subsequent changes in the capital structure and pricing. The fifth proof, dated 11 July 1899, has £250,000 of 5 per cent cumulative preference shares, £350,000 of ordinary shares and £200,000 of irredeemable 4 per cent mortgage debentures, all to be issued at par, a total of £800,000. A corrected proof dated 14 July 1899 changed the amount of Preference shares back up to £300,000, and reduced the Ordinary shares to £300,000, leaving the Debentures unchanged at £200,000. The final prospectus, dated 26 July, has these amounts. No ordinary shares were to be issued to the public: the Hambro and Hills requirements had been incompatible. They were instead to be retained by vendors, notably Hills. This was not viewed as a negative by potential investors in the debentures and Preference shares. Indeed, it was seen to be a positive factor. 'It should be added that confidence in all issues in this class [of companies being sold by vendors] is much strengthened when the original owners of the property agree to take a large part of the purchase price in shares, preferably ordinary shares, in the new company and thus demonstrate their belief in its future prosperity' (Le Maistre, 1926: 233).

## **4 - Disclosure and the Thames Iron Prospectus**

### **4.1 Stock Watering**

Hambro expressed interest in the asset valuation and profit figures. The former were relevant in providing asset backing for the proposed capital of the Company, the latter for covering interest and dividend payments. Hambro responded cautiously to Hills' 12 June suggestion of £375,000 each of Preference and Ordinary shares, trying to avoid 'watering the stock'. 'I am bound to say that even these figures which I suggest seem to me large, because your old capital was £300,000 and you are adding to it Penn's Works for ?£100,000'.<sup>21</sup> Stock was considered 'watered' if it was not backed by tangible assets or if it were backed by assets which were over-valued in the balance sheet:

"Watered stock" was repeatedly inveighed against as a deception practised upon the stock-buying public, who were misled by a fictitious statement of the asset values existing behind the shares. Hence one of the functions of security analysis was to discover whether the value of the fixed assets, as stated on the balance sheet of the

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<sup>21</sup> Hambro had doubtless deduced this from Hills' letter of 18 May 1899 in which he had referred to a 'then' ordinary share capital of £100,000 and 'now issued' £200,000 of ordinary shares.



company, fairly represented the actual cost or reasonable worth of the enterprise. (Graham and Dodd, 1934: 306)

Akroyd, of the major stockbroking firm of Cazenove, Akroyd & Co., had been consulted by Hambro on this topic. Hambro reported back to Hills that Akroyd ‘thinks it important that the valuation of the Accountant clearly showed £600,000 was the actual value of the property, not including tools’. Thus, both Hambro and Akroyd were concerned that the asset value should be robust, and seen to be robust in the Prospectus, which at the time was accorded great importance by potential investors (Jefferys, 1938). Under Hambro’s proposal of £700,000 of securities (£200,000 debentures, £200,000 of Preference shares and £300,000 of Ordinary shares), and with a solid asset valuation of £600,000, only £100,000 of ordinary shares would be ‘watered’. This could be tolerated in the context of the Ordinary shares, provided they offered a dividend of 10 per cent. This was a more conservative view than that expressed by the firms amalgamating to form Imperial Tobacco in 1901, when the merged firm was valued in terms of earning power (eight times net profits) plus the value of the tangible assets (Armstrong, 1990) or by Le Maistre, who later wrote about company flotations that ‘it is now generally accepted that goodwill should not ordinarily exceed 1 ¼ to 3 years’ purchase of the net profits of a business, after provision for depreciation has been made, based on the average of the last five years’ (1926: 149). Hambro did not consider profit in the sense of years’ purchase, but in the context of being able to generate a dividend yield.<sup>22</sup>

The various proofs of the prospectus show that the asset value remained a bone of contention. The proof dated 11 July included an estimate of the gross aggregate value of the combined premises, buildings, fixed plant, etc. of Thames Iron and John Penn of ‘£800,000, this valuation not including the many costly tools in the various yards’.<sup>23</sup> The valuation by Fuller, Horsey & Co., included in final prospectus dated 19 July, 1899, reduced that figure to £587,000, less than the original £600,000. However, the *total* assets acquired were given as just over £800,000, achieved by adding to the valuation figure a further £51,534 for tools and utensils (certified), £51,507 for stocks, stores &c.(uncertified), £69,015 working capital and £50,000 to be provided by the issue itself.

## 4.2 Profit Disclosure

As far as Thames Iron’s income was concerned, Hills had given two perspectives – a seven-year history of the wages-bill, which had increased from £99,066 in 1893 to £242, 838 in 1898, and a three-year certified aggregate profit figure of over £148,000.<sup>24</sup> He was proud of the wages-bill increase since it reflected the benefits of the Good Fellowship Scheme and lack of industrial unrest.<sup>25</sup> Hambro quashed the inclusion of the wages bill in the prospectus: ‘Unless the Auditors could show an increasing profit, I do not think if the fact that the Wages Bill had been going up would be taken as of any value, in fact, unless the Auditors’ Certificate showed the profit increased in the same proportion it would be a disadvantage to give it’. In the Prospectus, Hills was limited to an indirect mention of the Good Fellowship Scheme, with no numbers provided. ‘The vendor company has adopted the plan of interesting

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<sup>22</sup> For discussion of how company valuation techniques changed over time, see Rutterford (2004).

<sup>23</sup> Draft prospectus, Proof, 11 July 1899, MS19096.

<sup>24</sup> Letter from Hills to Hambro, 12 June 1899, MS19096.

<sup>25</sup> See, for example, the Introductory article in the first issue of the Thames Ironworks Quarterly Gazette, 1 (1895).

its staff and employees in the profits earned. This arrangement has proved to work with every satisfaction to both sides, and since its initiation in 1892 there has been complete immunity from labour troubles'.<sup>26</sup> There was no mention of the eight-hour day which would cause trouble later on.<sup>27</sup>

On profits in the Prospectus, Hambro also reported the views of Akroyd, of Cazenove, Akroyd & Co., that 'the certificate of profits for 3 years lumped together would not be very satisfactory, because underwriters would immediately ask why it had not been divided; and he thinks that, even if one of the years was slightly inferior to the other two, it would be better to show all three than lump them together'.<sup>28</sup> The final version of the prospectus, dated 19 July, included a statement of profits earned by the vendor company (excluding those of John Penn & Sons) of £146,064 for the four years 1895 to 1898, or an average of £36,516 per annum. However, the auditor's certificate, which was included in the prospectus, went into more detail, in particular showing an increasing trend of profits: £27,407 in 1895; £29,677 in 1896; £41,462 in 1898; and £47,518 in 1898.

Although audited, the profit figures given were misleading for a number of reasons. First, as Arnold has pointed out (2000: 141), the profit figures given were operating profits, before deduction of interest charges on loans (not disclosed in the prospectus), directors' fees and managing director's remuneration although after 'extensive expenditure' to keep buildings, plant and tools 'all in a state of complete efficiency'. They were thus not the profits available for payment of interest and dividends on the debentures, preference and ordinary shares. The Auditors pointed this out in the first paragraph of their report. However, they did not give figures for the missing items. In fact, directors' fees were, in 1900, £315, less than the £433 2s 6d paid to the Debenture trustees. They were also not necessarily a fixed cost. Reaching a high of £630 in the years 1904 to 1907, in the loss-making year of 1908 the directors chose to waive their fee altogether.<sup>29</sup>

As well as the problem of profit definition, determining annual profits for a Company such as Thames Iron over time was fraught with difficulty given the size of the ship-building contracts and the relatively low profit margins. For example, the Auditors reported the work in progress figure as at January 1895 of £140,000 compared with £877,000 at end 1898. They commented 'The length of time over which the carrying out of large construction work necessarily extends involves that the ascertainment of their results can be arrived at only at irregular intervals'.<sup>30</sup> They then apportioned the profits between each of the four years 1895, 1896, 1897 and 1898 by using the wages paid each as an indication of work done. In practice, the press, commenting on the new issue, picked up only the profit figures for the four years 1895 to 1898. No comment was made on the problem of profit estimation in such a business. *The Economist* was the most sceptical, reporting that the auditors, when looking at the four year profit total, 'think this may be divided as follows'.<sup>31</sup> *The Economist* then went on to recommend both the debentures and the preference shares as a 'sound investment'. A typical comment was that of *The Statist*: 'profits last year of over £47,000, and even in the dull time

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<sup>26</sup> Final prospectus, , MS18000/63B/562.

<sup>27</sup> See the Section entitled Outcome of this paper.

<sup>28</sup> Letter from Hambro to Hills, 14 June 1899, MS19096.

<sup>29</sup> Thames Iron Annual Report and Accounts, 1900 to 1910, Iron and Steel Company Annual Report and Accounts, Guildhall Library.

<sup>30</sup> Letter from Auditors, James & Edwards, included as Auditors' Report in the Prospectus, MS18000/63B/562.

<sup>31</sup> Press cuttings file, Ms19096.

of 1895 they were £27,000'.<sup>32</sup> Most newspapers preferred to make no comment on the figures and to concentrate on the nature of the business. As the *Newcastle Daily Journal* observed, 'demand for war vessels seems to be on the increase all over the world'.<sup>33</sup>

### 4.3 Reasons for the Issue

As far as reasons for the issue were concerned, the various drafts did not alter much. The key reasons given were the general increasing nature of the business, the need to pay off temporary loans, the extension of plant and machinery, and a catch-all 'general purposes'. No profit forecast was given although 'good results are anticipated'. Another feature of the prospectus was the importance given to Hills' leadership. The potential investor was reassured that Hills, who had been managing director for the past fifteen years, had entered into an agreement with the company to act in a similar manner for five years. It is also worth noting that the purchase price paid to the vendors was given in the prospectus as £750,000, payable as to £300,000 in ordinary shares and the rest in cash. This was £50,000 higher than given in the 14<sup>th</sup> July proof.

## 5 - The role of the broker

Hambro viewed his own role as being to comment and improve upon the suggested capital structure, taking into account market demand, to be aware of Stock Exchange regulation and company law and, in conjunction with the broker, to comment on the Prospectus, required, in 1899, by the Stock Exchange rather than by law (Armstrong, 1990). However, Hambro deferred to his Stock Exchange broker on detail such as pricing of securities and market timing of the issue. On these topics, the opinion of a good broker was paramount. It was the broker who knew what the underwriters would or would not accept. Hambro ended his 12 June letter to Hills saying that he had not consulted any broker as to the possible success of such an issue, warning only that recent issues had not gone well for shares in relatively small companies, so that a prospectus would have to be very attractive before people could be induced to subscribe.

Hills, in promoting his proposed capital structure of £375,000 each of Preference shares and Ordinary shares, argued that, in the absence of a debenture issue of any kind, the Preference shares should be issued at a premium of not less than £1 per share. Having the shares trade at a premium clearly reflected well on both the issuing house and the company concerned.<sup>34</sup> Hills argued for a premium by sending Hambro a press cutting of a 5 per cent cumulative preference share issue by William Cory and Son [coal merchants and shippers]: 'From the very first the five per cent cumulative preference shares of William Cory and Son were recognised as a good thing. Large applications were sent in when the prospectus was issued, and they were immediately quoted at a premium which has gradually increased until the £5 share is worth about £6 5s.'<sup>35</sup>

On 14 June, Hambro reported his consultations with the broker, Akroyd. Akroyd had taken note of Hambro's preferred capital structure for Thames Iron and commented on how these could be made attractive to underwriters:

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<sup>32</sup> Ibid.

<sup>33</sup> Ibid.

<sup>34</sup> As Hambro later commented in his letter to Trollope, 2 July 1903, MS19097, Guildhall Library.

<sup>35</sup> Enclosed press cutting with letter from Hills to Hambro, 31 May 1899, MS19096.

Mr Akroyd thinks that in ordinary times and under ordinary circumstances the Debentures and Preference shares of the proposed Company could be underwritten .... His idea is that if the Debentures were perpetual Debentures they might be issued at 102 ... and that the Preference would have to be issued at par.

The 5% to be offered on the Preference shares was in line with other issues and thus could only be offered at par. With a debenture issue now ranking ahead of the Preference shares, Hills lost the £1 premium he had hoped to achieve. There was also a change in the nominal value: the 11 July prospectus referred to £5 nominal Preference shares – by 14 July, these were £1 nominal.

Just as preference shares then had to be cumulative in order to be successfully issued, so irredeemable debentures were then considered more attractive in the British market than fixed maturity Debentures. Irredeemable debentures resembled Preference shares and Ordinary shares in their lack of redemption date, and were thus considered to be part of the capital of the firm.<sup>36</sup> An early undated draft Thames Iron prospectus had specifically mentioned 'redeemable' debentures. Making the Thames Iron debentures perpetual would, according to Akroyd, allow them to be offered at a £2 premium. The Thames Iron debentures were also to be first mortgage debentures, secured by a floating charge on the freehold and leasehold property, and on all other property including uncalled capital; this floating charge feature had become general by this time (Baskin and Moranti, 1997: 147).

The debentures, when issued, had a 4 per cent per annum coupon, to be paid semi-annually on 15 April and 15 October of each year, and were indeed, irredeemable. However, Hambro and his lawyer, Broad, failed to spot a flaw in the wording describing the Debentures in the Prospectus, which said that they were 'irredeemable, unless the company goes into liquidation, in which case the Debentures will be repayable at the rate of 110 per cent' of their par value.<sup>37</sup> The secretary of the Stock Exchange Committee which met to approve the listing of the new Thames Iron debentures and Preference shares, noted that 'insufficient care has been taken in the statement of those terms in the prospectus ... Unless, therefore, the expression goes into liquidation is voluntary, it is probable that the Stockholders could enforce the more favourable terms of the Prospectus and claim the premium of 10 per cent in case of a liquidation, whether favourable or otherwise'.<sup>38</sup> The principal indenture of the mortgage debt had to be altered.

Another key role of both Hambro and the broker was to decide exactly when the new issue should be launched to best effect. For the London market, this meant knowing about demand for domestic industrial and commercial securities, such as Thames Iron, in the context of international issues taking place. Hills, writing his initial letters to Hambro in May 1899, had hoped to get the issue away before the holidays. Hambro reported that the Akroyd's opinion was that 'the business might be done if everything was ready to come out at a favourable moment, but he hardly seems to think that that favourable moment will come until after the holidays' given the fact that 'at the present moment, underwriters are smarting from the

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<sup>36</sup> See Cottrell (1980). This was not true of the American market where the preferred maturity of Debentures was under ten years (Baskin and Moranti, 1997).

<sup>37</sup> Note dated 20 December 1899 by J.A. Torrens-Johnson of the Stock Exchange Committee considering the application for listing of the Debentures and Preference shares. MS18000/63B/562.

<sup>38</sup> Ibid.

results of the Japanese issue'.<sup>39</sup> However, Hills had his way. The prospectus was dated 26 July 1899.

## 6 - Underwriting

Underwriting was legalised by the Companies Acts of 1900 and 1907 although, in 1899, underwriting was possible, so long as paid for by the vendor (in this case Hills) rather than the company itself and provided the shares were not issued at a discount to par value (Jefferys, 1938: 344). The 1900 Act required disclosure of the underwriting details but, to some extent, made underwriting less necessary, as minimum subscription payments were laid down, as was a minimum number of shares to be applied for before shares could be allotted (Cottrell, 1980: 70-3). Underwriting ensured that the entire issue was sold at the price given in the prospectus. Failure to underwrite could mean that some capital was not issued, the proceeds were reduced, and could also mean failure to gain a quotation for the securities, given the requirements imposed by the Stock Exchange

Hills initially expected to have the new issue underwritten: 'If this Preference issue in your opinion requires underwriting, I shall be willing to pay a commission of up to 5% for the service'.<sup>40</sup> Hambro replied with the opinion of Akroyd of Cazenove, Akroyd & Co., who believed that perpetual Debentures could be underwritten for 3%, to include the broker's commission of ½ per cent, and the Preference Shares for 3 ½ per cent, also to include the broker's commission.<sup>41</sup> A letter to Hills five days later enclosed an introduction to Akroyd, at the same time giving Hills the estimated costs of the issue without underwriting: ½ per cent for Hambros (minimum £1,250), ¼ per cent brokerage on debentures placed, 6d per share brokerage on the Preference shares placed, £100 for getting quotations on the Stock Exchange (which had to be paid by Hambros), about £600 to £700 on advertisements, depending on the number of papers, and legal expenses.<sup>42</sup> Hills wrote on 4 July 1899 to say that he would call on Hambro about the underwriting 'which should be arranged in the course of the next week'.<sup>43</sup> None of the draft proofs mention underwriting but the actual prospectus, dated 26 July 1899, rather surprisingly states: 'Nothing whatever is charged or paid for goodwill and the issue is not underwritten'. What had happened at the meeting in early July? Had Hills believed that the issue would be so successful that it was a waste of money underwriting it? Had the fact that he had specifically arranged with an advertising agency to publish the prospectus in the religious press encouraged this belief?<sup>44</sup> Had he been unimpressed with Hambro's or Akroyd's arguments. The archive is silent on this point.

In the event, the 4 per cent Debentures were issued at par and were oversubscribed, with applications for £312,400 of stock, 56% more than the £200,000 issued. Akroyd had been right in that there was substantial demand for perpetual 4 per cent Debenture Stock, with Northern Assurance Company, Edinburgh Life Assurance Company, and the Standard Life Assurance Company applying for £20,000 each. However, the 5 per cent cumulative Preference shares were less popular. Only £232,753 were applied for out of the £300,000 on offer, forcing Hills to take the balance in lieu of cash as part payment for the sale of the

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<sup>39</sup> Letter from Hambro to Hills, 14 June 1899, MS19096.

<sup>40</sup> Letter from Hills to Hambro, 12 June 1899, MS19096.

<sup>41</sup> Letter from Hambro to Hills, 14 June 1899, MS19096.

<sup>42</sup> Handwritten note from Hambro to Hills, 19 June 1899, MS19096.

<sup>43</sup> Letter from Hills to Hambro, 4 July 1899, MS19096.

<sup>44</sup> Letter from Cheston & Sons, solicitors, to Thames Ironworks, 18 July 1899, MS19096.

company. It had originally been agreed that he would take one third of the original issue size of £250,000, later changed to £75,000. To this was added a further £70,357.<sup>45</sup> Perhaps Hills had decided that, even if the issue were not fully subscribed - a risk with an issue which was not underwritten - he was more than happy to bridge the gap.

## 7 - Trollope, Colls & Co.

In this section, we now look at the second correspondence archive, that relating to the new issue of securities by Trollope, Colls & Co. under the aegis of Hambro's Bank. On 5 February 1903, George Trollope wrote to Hambro, asking for help in floating his company. The story was a common one, of illness and merger, and the tone was respectful:

Since the great gap left in the firm by my brother Frank's death following that of another partner, we have been considering what best to do for the future welfare of the business and we have thought – after much deliberation – that for the purposes of continuity – and convenience – it would be better to convert this part of the business – that is the building decorating and furnishing – into a limited company. This we proposed doing in conjunction with our friends ... Colls of Coleman St. City, well-known builders doing a first class business and who are thinking of the same thing. We propose to keep the capital to a very modest £300,000 half preference and half ordinary shares, keeping the ordinary shares ourselves. The assets would be upwards of £225,000 and the average profits about £45,000. If this is not too small a matter for you, I need hardly say, I am your...<sup>46</sup>

The correspondence is less rich on the stages of the capital structure process than the Thames Iron archive. However, greed was clearly not a factor in the capital structure decision, since Trollope's original suggestion of £300,000, half in Preference shares and half in Ordinary shares, was replaced in the final prospectus by £200,000 5 ½ per cent Cumulative Preference Shares and £250,000 of Ordinary shares, with the whole of the Ordinary shares (apart from £3,000 of Directors' shares) retained by the vendors, Trollope and Colls. No Debentures were issued, or intended to be issued, and this doubtless reflects the relatively small asset base which was primarily work in progress and a limited amount of tools and stock-in-trade. Hambro had intervened on the legal side with respect to the Debentures: 'As regards Trollope, Colls & Co., they have no intention at all of putting anything in front of the Preference shares, but I stipulated there should be a clause in the articles of association prohibiting them from ever doing so without the consent of a large majority of the Preference shareholders'.<sup>47</sup> He also arranged for Trollope and Colls, with their lawyers, to meet Broad, Hambro's lawyer, who 'will then go into the whole legal part of the business and will assist them in drawing up a prospectus for our approval'.<sup>48</sup>

It is not clear who took the decision to increase the total capital of the Company from £300,000 to £450,000, an increase of 50 per cent; however, it was Hambro who had the final word on the total and on the proportions of Preference shares and Ordinary shares. An undated note in Hambro's handwriting has £225,000 Ordinary and £225,000 Preference

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<sup>45</sup> MS18000/63B/562.

<sup>46</sup> Letter to Hambro from George Trollope, 5 February 1903, MS19097.

<sup>47</sup> Letter from Hambro to Heriot, dated 29 June 1903. The prospectus stated that a majority of three fourths of the preference shareholders would have to approve at a special meeting. MS19097.

<sup>48</sup> Ibid.

shares.<sup>49</sup> A later Hambro memo to Heriot comments: 'I think I have also arranged with them to reduce the amount of the preference capital to £200,000, increasing the ordinary to £250,000. Nothing could be nicer than the way Trollope behaved'.<sup>50</sup> With this, the final capital structure, the three vendors, George Trollope, H. Trollope and J.H. Colls, received £247,000 in Ordinary Shares and £152,999 in cash, a total of £399,999. Under Trollope's original suggestion, the maximum they could have received, after allowing for £50,000 working capital would have been £300,000. As a result of discussions with Hambro and their brokers, the vendors were £100,000 better off.

The capital raised was £200,000 in cumulative preference shares and £200,000 in ordinary shares, a total of £400,000. The asset value (in the usual course of business) was £236,060 excluding goodwill, somewhat above £225,000 as Trollope had stated in his original letter. This, with the traditional £50,000 of working capital from the issue proceeds, gave a total asset value of £286,060 more than covering the Preference shares and contributing £86,060 of asset cover to the Ordinary shares.

For Trollope, Colls & Co., there was a question mark over the coupon to be paid on the Preference shares. As for Thames Iron, the broker's view was paramount on pricing. In an internal note, Hambro commented: 'Henderson [a broker] would not take Trollope Pref at 5 but we agreed we would at 5 ½ - if T[rollope] wants 5% then you must ask H[enderson]'.<sup>51</sup> At some point, Hambro must have suggested a 6 per cent coupon on the Preference shares and Colls wrote to Trollope saying that this was too high. Trollope forwarded the Colls letter (missing from the archive) to Hambro, who replied:

I return your enclosure. As regards 6 per cent interest on your preference shares, the last thing I meant to do was to do anything that in sense could be considered damaging to your firm's credit. I said 6 per cent, because the only thing I could compare it to was Waring's 6 per cent preference shares. While it is true they command a premium now, I should be sorry, both for your sake and ours, if the issue of your preference shares did not go to a premium also.<sup>52</sup>

In a note to Heriot, two months later, and three months before the issue, Hambro commented: 'I thought the type of interest was to be 5 per cent but if they will pay 5 ½ or 6 per cent, the issue will be more attractive'.<sup>53</sup> The final prospectus shows that 5 ½ per cent was the coupon agreed upon.

The Trollope, Colls & Co. prospectus differed from that of Thames Iron in one important point. The auditors did not give either an annual or an average profit figure. They limited themselves to an estimate of dividend cover. 'The joint profits of the two firms have during each of the last three years been more than four times the amount of the dividend on the present issue of the preference shares. Such profits for the year 1902 were greater than those of either of the two preceding years'. From the correspondence between Hambro and Colls, we know that the average profit was in fact £45,000. After payment of the Preference share dividend of £11,000 (as stated, less than one quarter of average profits), this in theory left £34,000 for Trollope Ordinary shareholders. If a 10% dividend were paid on Ordinary shares, (the rate given as desirable by Hambro for Thames Iron), there would still have remained

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<sup>49</sup> Ibid.

<sup>50</sup> Ibid.

<sup>51</sup> Undated note by Hambro, MS19097.

<sup>52</sup> Letter from Hambro to Trollope, 2 July 1903, MS19097.

<sup>53</sup> Note from Hambro to Heriot, 1 September 1903, MS19097.

£9,000 profit that could be set aside as reserves. This was in line with the average for new issues of the period where three quarters of profits were paid out in dividends on Preference and Ordinary shares. It was also usual to assess Preference shares in the context of the earning power of the company, rather than on asset backing (Jefferys, 1938). Given their earnings cover, the Trollope, Colls & Co. Preference shares, paying 5 ½ per cent, were clearly less risky than those of Thames Iron, paying 5 per cent.

Despite the fairly conservative capital structure, and despite the fact that, following legislation (Cottrell, 1980: 73), the prospectus stated that the minimum subscription on which the directors would proceed to allotment was £200,000, the Trollope, Colls & Co. issue was underwritten. There was, however, some discussion with Trollope as to the fees, after negative comment by Colls, clearly a thrifty businessman. Hambro felt obliged to explain the charges in a letter to Trollope dated 1 July 1903.

As regards the second part of Mr Coll's letter, when I named 3 per cent for underwriting, you must remember I named a figure much lower than that which is customary in similar cases, because I hoped and believed that a great number of your customers and merchants would subscribe for the shares at issue, and certainly there would be no difficulty in sending them the prospectus so that it would arrive to them as quickly as to anybody else, or in allotting them as much as possible in the interests of your firm. The 5% named by me was to cover brokerages and everything else, except legal, advertising expenses and stamps.<sup>54</sup>

The issue, which became dormant, was resuscitated in September when Hambro wrote an internal note saying that he had found Trollope's letter in a drawer. His memory of previous discussions with Trollope and Henderson's, 'was that the following was agreed: Commission to Hambro's 2 per cent out of which we pay the brokerage. Underwriting commission 3 per cent and Henderson and we share the underwriting. Trollope to pay all expenses'.<sup>55</sup> In the actual prospectus, Henderson's were not mentioned, with the 3% underwriting commission and 2% commission (to cover the cost of printing, issuing and advertising the prospectus, brokerage and all other charges) attributed to Hambros. The vendors were to pay the preliminary expenses, estimated at £4,500, for company registration, solicitors' and accountants' fees, as well as Stamp duties. After an initial approach in February 1903, the issue was finally launched in December of the same year.

In a note dating from the time when Hambros Bank had been due to underwrite only half the issue, Hambro commented that the directors wanted £20,000 of the Preference shares (as well as their Ordinary shares), and that a further £10,000 was required for the Pension fund and that Dick (presumably Richard Heriot) wanted £1,000. 'So our own half is going fast'.<sup>56</sup> In addition, lists were provided by both Colls and Trollope of people to whom the prospectus should be sent, forming part of the minimum 3,000 prospectuses to be issued and circulated by Hambro under the final underwriting agreement. The prospectus had said that special consideration would be given to applicants connected with or customers of the business. In the end, £265,370 were applied for and £200,000 allotted. The issue was a success, perhaps due to the reputation of the 'thoroughly practical men' who ran the two businesses begun in 1778 and 1840, and without the need for full profit disclosure. As *The Economist* commented, 'the firms undoubtedly enjoy a good reputation and it is upon this and upon the

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<sup>54</sup> Letter from Hambro to Trollope, 2 July 1903, MS19097.

<sup>55</sup> Note from Hambro to Heriot, 1 September 1903, MS19097.

<sup>56</sup> Undated note in Hambro's handwriting, MS19097.



ability of the partners ... to conduct the business with the same success as in the past that investors must mainly rely if they decide to take an interest in the concern' (5 December 1903: 1029).

## 8 - Role of Hambro

In this section, the role of Hambro in re-financing both Thames Iron and Trollope, Colls & Co. is discussed. In terms of personal relationships, there is some sense of social equality with Hills, who had been to public school and Oxford, with Hills passing on information about mining investments in British Columbia, only to find that Hambro had already invested in another syndicate in the same region.<sup>57</sup> They spoke of their holidays and met several times. Although Hills, despite all his contributions to the Thames ship-building industry, his workforce, and vegetarianism, was never given any recognition in the form of an honour, unlike the key figures in the City (Cassis, 1994). The tone of the correspondence between Trollope and Hambro is more distant, with no mention of social activities or points of common interest, and the damning 'found letter in desk' forgetfulness on the part of Hambro. Hambros Bank, and Hambro in particular, were not involved in the company mergers which had preceded both the Thames Iron and the Trollope, Colls & Co. new issues. For example, Hambro wrote to Hills saying that he did not feel able to comment on the economic rationale behind the merger with Penn's engineering works, trusting to Hills' business sense. However, he was critical of the price apparently paid:

Of course I do not know whether the valuation you give of £600,000 includes Penn's, nor do I know whether you could show that Penn's business was an increasing one, and that its past profits would justify the price you have paid, though I thoroughly understand that their Works may be worth the sum to you to join them to your own.<sup>58</sup>

Hambro did not comment on the viability of the proposed capital structures for Thames Iron and Trollope, Colls & Co. in the context of the risks and returns of these businesses. He appeared concerned with capital structure only insofar as ensuring that the securities involved would be considered appropriate by the investing public. For Thames Iron, Hambro recommended a capital structure which allowed – on current profitability – a 10 per cent dividend, with no allowance for reserves. 10 per cent was a normal dividend yield for an industrial at the time but, given the risk (clear from its previous history) of the ship-building industry, and the fact that it was highly competitive, the suggested dividend yield was low<sup>59</sup>. At no point in the correspondence is there any mention of industry factors, except to comment on the coupons or dividend yields of rivals' securities. Hambro certainly never visited the companies concerned to try to understand their business.<sup>60</sup> Thames Iron was less profitable than Trollope, Colls & Co., and yet offered a lower yield on the Ordinary shares. In order to offer even 10 per cent, Thames Iron had to issue more low coupon fixed interest senior securities (62.5% of total capital) than did Trollope, Colls & Co (44%). This was helped by the greater asset base at the disposal of Thames Iron, but meant that the Preference shares, with a lower coupon than Trollope, Colls', were riskier. In order to generate sufficient profits

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<sup>57</sup> Letter from Hills to Hambro, 12 June 1899, MS19097.

<sup>58</sup> Letter from Hambro to Hills, 12 June 1899, MS19096.

<sup>59</sup> In practice, the dividend yield never reached 10% after the issue and no ordinary dividend was paid after 1906.

<sup>60</sup> Although he did send his lawyer, Broad, to visit Thames Iron.

which were relatively stable, Thames Iron needed either better management, lower costs, or economies of scale achieved through a cartel or merger with competitors, such as had been formed by the Armaments Ring (Pollard, 1950: 87). Or, it needed someone to persuade the Admiralty of the case for paying workers higher wages in the South than in the North of England, by paying more for the ships they built.

The behaviour of Hambro and his associates in the City, can be compared with that of J.P. Morgan and his investment bank, J.P. Morgan and Co., in promoting and directing major US companies at around the same time. “Morganization”, described as ‘the extraction of monopoly rents from consumers’, consisted in amalgamating firms in the same industry to give them economies of scale and the ability to charge higher prices (De Long, 1991). Charging high fees (between 4 and 10 per cent of the (inflated) value of the businesses involved (De Long, 1991: 3) this approach to investment banking can be said to have three advantages: one for vendors of the businesses and two for potential investors. Book values of “Morganized” companies represented not the cost of the physical assets but Morgan’s assessment of their earning power (Dewing, 1914). This meant, for the vendors, that they received a higher price for their companies than they otherwise would have. De Long argues that the lack of such a mechanism in the UK can explain the failure of British companies to make the transition from ‘paternalistic capitalism’ to ‘professionally managed’ organizations with diversified stock ownership (1991: 33). The second advantage, put forward by Moody, was that J.P. Morgan and Co. did not walk away from the companies they promoted after the issue. They put directors on the Board, thereby ensuring effective monitoring of the firm’s managers, signalling to investors that management was both competent and industrious and making it more likely that the firm would survive. Incompetent managers could be fired (Moody, 1904; Moody, 1912). The third advantage, suggested by a partner in J.P. Morgan, was that promotion by firms such as J.P. Morgan and Co. provided a guarantee to the ‘thousands of investors ... seeking securities’ who ‘have neither the knowledge nor the opportunity for investigating a great ... enterprise’ (De Long, 1991: 14). J. P. Morgan invested in the companies he promoted (even if at advantageous prices) and this provided a signal to the market. De Long argues that the commissions charged by J. P. Morgan were high but still worth the advantages brought by “Morganization”.

What was the advantage of issuing securities using the name of Hambro? Hambro provided legal advice, advice on a marketable capital structure, comments on the figures to be included in the Prospectus, and access to a reliable broker and the Stock Exchange. Hambro did not invest in, nor expect clients of his bank to invest in, either firm’s securities although Richard Heriot of Hambros does appear to have invested £1,000 in the Trollope. In both cases, the vendors achieved higher sales prices for their companies than their original suggestions. However, Hambro’s primary aim was not to structure the businesses optimally for future success; it was to ensure that the securities offered to the stock market had appropriate and normal yields. Key value was provided by the Stock Exchange, which gave the securities the seal of approval via a special settlement day and a quotation. Hambro offered little competitive advantage over a reliable stockbroker. Perhaps Hills felt happier dealing with Hambro than with brokers, at least to begin with. At least Hills saved the 3 per cent underwriting commission, although at the cost of having to take even hold even more Thames Iron securities. He hoped, no doubt, to sell these into the market after the issue. He did not, though, achieve a quotation for the Ordinary Shares, making his holding illiquid in the extreme. Trollope and Colls, on the other hand, by underwriting the Preference share issue

were sure of the proceeds. The commission was also relatively low at 3 per cent, reflecting the fact that they were expected to bring investors to the issue. Perhaps issuing via Hambro added respectability and status to a company such as Trollope, Colls, & Co.

## 9 - Outcome

Trollope, Colls & Co. continued after 1903 to generate large profits, well able to pay the dividend on the Preference shares and also able to pay generous dividends on the Ordinary shares. The firm was able to expand using retained earnings and the capital structure remained the same until 1953 when the £10 Ordinary shares were subdivided into 10 £1 Ordinary shares. Trollope, Colls & Co. was acquired by the Trafalgar House conglomerate in 1968, in turn later subsumed into the Kvaerner Group. The Trollope, Colls & Co. brand name is still used for the UK construction activity.

In contrast, Thames Iron had returned to the stock market within two years of the 1899 restructuring. In 1901, Thames Iron issued £100,000 of 5 per cent Second Mortgage Debenture Stock, redeemable in 1911 at par or at £105 at three months' notice or on liquidation, and with a sinking fund.<sup>61</sup> This later debenture issue was perhaps rejected by or too small for Hambro, being offered for subscription by Messrs J.S. Morgan and Coy who charged 5 per cent underwriting commission and issued the debentures at a discount, at £97 ½. Certainly, Hills did not reduce issuing costs by using a firm other than Hambros. The 1899 issue had not provided sufficient working capital, most of the proceeds having gone to the directors. In this instance, 'the magnitude of contracts in sight and increasing volume of business made it necessary to provide further working capital'.<sup>62</sup> Prior to the second debenture issue, Hills and Thames Iron's bankers, London and Westminster, had both provided temporary loans.

Thames Iron made modest profits and losses until 1908, when the company made a substantial loss of £36,278 and the directors waived their fee. By 1909, the firm, through the sterling efforts of Hills, had acquired an order to build HMS Thunderer, a major ship-building contract. By that time, the Second Mortgage debentures had been partially redeemed, with only £59,454 outstanding. It was agreed to increase the Second Debentures issued up to £150,000 and this was done by 1910 when the capital was £300,000 5 per cent cumulative preference shares, £300,000 ordinary shares, with £201,859 of First Mortgage Irredeemable Debenture Stock<sup>63</sup> and £150,000 of Second Mortgage Redeemable Debenture Stock.<sup>64</sup> This issue does not seem to have been made either via Hambro or via a broker and is likely to have been primarily financed by Hills. At the same time, the company had built up £115,000 of bank loans and overdrafts, and £93,600 of the Second Mortgage Debenture Stock was

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<sup>61</sup> MS18000/72B/6. The same mistake was not made vis-à-vis the liquidation. The liquidation had to be 'voluntary'. This Second Mortgage Debenture Stock had a requirement that, before any dividends were paid on Preference or Ordinary shares, £5,000 of surplus profits should be paid to Trustees who could, if required by the Company, redeem some Debentures at up to £105 or set the sum aside for future redemptions. A sinking fund had not been required for the irredeemable debenture issued in 1899. See le Maistre (1926).

<sup>62</sup> MS18000/63B/562.

<sup>63</sup> The amount was in excess of £200,000 as Hills had encouraged employees, via articles in the Thames Ironworks Quarterly Gazette, to invest in instalments in these Debentures. See, for example, Volume 1, No. 1, 1895.

<sup>64</sup> See Thames Iron's Annual Report and Accounts for the year 1910, Iron and Steel Company Annual Report and Accounts, Guildhall Library.

deposited with the bankers as security.<sup>65</sup> The increased capital financed £696,454 of work in progress and £746,276 of premises.

After delivery of HMS Thunderer (a 'pyrrhic victory' (Arnold, 2000: 145), there were no new orders for Thames Iron despite heroic efforts by Hills, who had been confined to a wheelchair since 1906.<sup>66</sup> Hills did not lose heart, however. In June 1911, the *Times* recorded that Thames Iron was proposing to make an issue of £300,000 of Second Debentures bonds bearing interest at 5% and redeemable by annual drawings over 20 years, the money being required 'for extension of business'. The prospectus could be obtained from the company's offices.<sup>67</sup> No bank or broker appears to have been involved. The issue did not go ahead. Instead, the company's bank, in November 1911, refused to honour the company's cheques, and a receiver-manager was appointed on behalf of the debenture-holders. The Admiralty offered to give further work to Thames Iron on condition that they gave up the eight-hour day (48 hour week) and could assure 'good management' (Arnold, 2000; 148-9). The men, conscious of the fact that the Admiralty, in its own yards, had an eight-hour day and that there was a national campaign for a 48-hour week, voted against.<sup>68</sup> In 1912, an offer was made to acquire the assets of the company, in the books at £800,000, for £300,000. This sum meant that the first debenture holders would be paid off in full, the second debenture holders would be partially paid off, and the preference and ordinary shareholders would receive nothing at all. Not surprisingly, the first debenture holders were in favour.<sup>69</sup> Hills held a meeting of the Preference shareholders, asking them to be assessed at 5 shillings for each pound of stock in a proposed reconstruction. There was animated debate, with investors critical of Hills' management style 'being too much inclined to favour the workmen who were a body of socialists'.<sup>70</sup> One investor inveighed against the eight-hour day, saying that 'he had worked ten hours a day and more and was none the worse for it'.<sup>71</sup> Despite these criticisms, the resolution was passed. Later that day, Hills asked the First Debenture holders, guaranteed full repayment if the proposed purchase went ahead, to consent instead to a reconstruction involving 50% repayment of their capital, with interest on the remainder raised from 4 to 5 per cent. This resolution was lost by a single vote. The company finally closed its doors in December 1912.

## 10 - Conclusion

This article has explored the process by which Thames Iron and Trollope, Colls & Co. were restructured and made new issues on the London Stock Exchange, using Hambros Bank as intermediary. It is clear from the correspondence between Everard Hambro and the chairmen of the two companies that the capital structure decision was in both cases jointly discussed, with the chairmen making initial suggestions and Hambro having the last word. The factors which the chairmen took into consideration were the ability to retain control of the ordinary shares, the need for working capital and the positive publicity which a successful new issue would ensure. The factors which Hambro took into consideration were legal and regulatory –

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<sup>65</sup> The increase in the size of the Debenture issue may have been at the bank's behest.

<sup>66</sup> *The Times*, 8 March 1927.

<sup>67</sup> *The Times*, 24 June 1911.

<sup>68</sup> *The Times*, 6 January 1912.

<sup>69</sup> Letter to *The Times*, 15 March 1912.

<sup>70</sup> *The Times*, 9 March 1912.

<sup>71</sup> *Ibid.*

the minimum amount of free float required by the Stock Exchange, the contents of the Articles of Association – and also market-driven. Hambro emphasised the need to match similar and recent new issues in terms of capital structure, yield, pricing and security characteristics, relying heavily on advice from his broker. Hambro also intervened in terms of prospectus content and disclosure of accounting information, in particular historic profits and asset values. The prospectus information provided was there to reassure investors that the proposed securities were well-backed in terms of income and asset cover. In particular, Hambro intervened to prevent too much ‘stock watering’ and to ensure a high enough yield was offered on fixed-rate securities.

However, Hambro did not take account of the particular risks of the businesses in formulating his advice. This was of little importance to Trollope, Colls & Co., which did not need external funding to survive. It was of significant importance to Thames Iron, which would have benefited from advice in terms of industry restructuring and an injection of management expertise. Despite relative social ease between the Chairman of Thames Iron and Everard Hambro, no long term financial advisory relationship was established nor ongoing financial advice offered. The new issue advantages which were offered by Hambro, notably marketability, speed of issue and relatively low costs, did not help Thames Iron in the long run and it is significant that Hills did not turn to Hambro for further refinancing issues.

In both cases, Hambro kept his distance from the firms which he introduced to the stock market. Cairncross attributes this attitude lack of industrial expertise: ‘the London merchant banks did not possess the apparatus of investigation necessary for home industrial flotations, but were admirably placed for the handling of loans to foreign governments and corporations ...They were under no temptation to dabble in home industrial issues (except the very largest).’<sup>72</sup> An alternative view is that Hambro concurred with Lord Revelstoke of Barings, who famously remarked in 1911, ‘I confess that personally I have a horror of all industrial companies and that I should not think of placing my hard-earned gains into such as venture’.<sup>73</sup>

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<sup>73</sup> Ziegler, 1988: 186.

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